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IN THE

Supreme Court of the United States

STONERIDGE INVESTMENT PARTNERS, LLC,
Petitioner,

v.

SCIENTIFIC-ATLANTA, INC. and MOTOROLA, INC.,
Respondents.

On Writ of Certiorari to the United States Court of Appeals for the Eighth Circuit

BRIEF OF THE REGENTS OF THE UNIVERSITY OF CALIFORNIA, COURT-APPOINTED LEAD PLAINTIFF IN THE *ENRON SECURITIES LITIGATION*, AS *AMICUS CURIAE* IN SUPPORT OF PETITIONER

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QUESTION PRESENTED

Does liability exist under §10(b) of the Securities Exchange Act of 1934 and Securities and Exchange Commission Rule 10b-5, where an actor knowingly uses or employs deceptive devices and contrivances as part of a scheme to defraud investors in another public company, but itself makes no affirmative misrepresentations to the market?

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INTEREST OF *AMICUS CURIAE*

The Regents of the University of California ("The Regents"), which suffered losses exceeding $140 million in connection with the notorious Enron fraud, appears in this matter in its capacity as the court-appointed Lead Plaintiff authorized under 15 U.S.C. §78u-4(a)(3) to act in connection with the *Enron* securities litigation on behalf of a class of all persons who purchased the publicly traded securities of Enron Corporation between October 19, 1998, and November 27, 2001. *See In re Enron Corp. Sec. Litig.*, 206 F.R.D. 427 (S.D. Tex. 2002).[1]

With a mission of teaching, research, and public service, the University of California is the nation's premier research university, and The Regents is the instrumentality of the state, "fully empowered in respect of the organization and government of the university, which, as it has been held, is a constitutional department or function of the state government."[2]

With 10 campuses, more than 201,000 students, and better than 160,000 employees, the University is governed by its 26-member Board of Regents. Pursuant to its constitutional authority, The Regents serves as a fiduciary for the University's pension and endowment funds, overseeing more than $50 billion invested in publicly traded U.S. securities.

The Regents accordingly has a strong interest in enforcement of our nation's securities laws — to ensure the transpar-

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[1] This *amicus* brief is filed with all parties' consent. No counsel for any party to this matter authored this brief or any portion of it, and no party has made any monetary contribution to the preparation or submission of this brief. As noted in text, The Regents is court-appointed Lead Plaintiff in the *Enron* securities litigation. The Regents or its counsel may ultimately seek compensation in that case for the work and expenses incurred in preparing this brief.

[2] *Hamilton v. Regents of the Univ. of Cal.*, 293 U.S. 245, 257 (1934); *see* Cal. Const. art. IX, §9; *Ishimatsu v. Regents of Univ. of Cal.*, 266 Cal. App. 2d 854, 864, 72 Cal. Rptr. 756, 763 (1968). Citations and footnotes are omitted and emphasis is added unless otherwise noted.

ency and integrity of the securities markets, and that victims of fraud are compensated. In February 2002, moreover, The Regents was appointed by the United States District Court for the Southern District of Texas to serve as Lead Plaintiff for a class of investors who purchased Enron securities. *See Enron*, 206 F.R.D. at 454-59. In that capacity The Regents is prosecuting claims against many defendants who, acting together, hid Enron's debt and fabricated Enron's financial results — thereby defrauding many thousands of investors out of billions of dollars. Many lost their life savings. The Regents suffered more than $140 million in losses due to fraud in connection with its purchases of Enron securities.

Featuring a complex scheme perpetrated by many participants and over many years, the Enron fraud is emblematic of the recent wave of corporate scandals that has shaken confidence in U.S. securities markets. *See In re Enron Corp. Sec. Litig.*, 235 F. Supp. 2d 549, 613-85, 692-707 (S.D. Tex. 2002).[3] Denying motions to dismiss, the district court in *Enron* held that The Regents was entitled to proceed under §10(b) against entities, including Merrill Lynch and Credit Suisse, who designed and implemented deceptive financial transactions in order to hide Enron's debt and inflate Enron's reported financial results, because they had actively engaged in a scheme to defraud investors by executing their deceptive devices and contrivances. *See, e.g., In re Enron Corp. Sec. Litig.*, 310 F. Supp. 2d 819, 827-30 (S.D. Tex. 2004);[4] *Enron*, 235 F. Supp. 2d at 581-94, 613-707.

The district court then certified a class, holding again that §10(b)'s proscription of "deceptive" devices is broad enough to cover Enron's bankers' central role in "'transaction[s]

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[3] The quoted opinion is reproduced in the Appendix to the *Enron* Petition for Certioriari, captioned *The Regents of the Univ. of Cal. v. Merrill Lynch Pierce Fenner & Smith*, No. 06-1341, at 407a-678a cited hereafter as "*Enron* Pet. Appx."

[4] *Enron* Pet. Appx. at 329a-406a.

whose principal purpose and effect is to create a false appearance of revenues.'" *In re Enron Corp. Sec. Litig.*, No. H-01-3624, 2006 U.S. Dist. LEXIS 43146, at *167 (S.D. Tex. June 5, 2006) (first class-certification opinion and order)[5]; *see also In re Enron Corp. Sec. Litig.*, 236 F.R.D. 313 (S.D. Tex. 2006) (second class-certification opinion and order).[6] Judge Harmon's opinion specifically tracked the SEC's position that under §10(b) and Rule 10b-5 "a 'deceptive act' includes a 'transaction whose principal purpose and effect is to create a false appearance of revenues,' which can be accomplished by acts as well as by words." *Enron*, 2006 U.S. Dist. LEXIS 43146, at *167. The *Enron* district court found persuasive the SEC's distinctions between deceptive acts, on the one hand, and aiding and abetting, on the other, and expressly adopted the SEC's approach to certify a class. *Id.* at *173. The SEC itself had explained, in an *amicus curiae* brief before the Ninth Circuit, that:

> "[D]eceptive acts under Section 10(b) include conduct beyond the making of false statements or misleading omissions, for facts effectively can be misrepresented by actions as well as words. For example, if an investment bank falsely states that a client company has sound credit, there is no dispute that it can be primarily liable. If the bank creates an off-balance-sheet sham entity that has the purpose and effect of hiding the company debt, it has achieved the same deception, and liability should be equally available."

Enron, 2006 U.S. Dist. LEXIS 43146, at *165 (quoting SEC *amicus curiae* brief from *Simpson v. AOL Time Warner*, 452 F.3d 1040 (9th Cir. 2006), *petition for cert. filed*, (Oct. 19, 2006) (No. 06-560)).[7]

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[5] *Enron* Pet. Appx. at 58a-296a.

[6] *Enron* Pet. Appx. at 297a-310a.

[7] The Brief of The SEC as *Amicus Curiae*, in *Simpson v. Homestore, Inc.*, No. 04-55665 (9th Cir. Oct. 22, 2004), is available at www.sec.gov/litigation/briefs/homestore192194.pdf.

Enron's bankers, who had devised and executed the sham transactions that hid Enron's debt and that generated its phony financial results, obtained leave from the Fifth Circuit to take an interlocutory appeal. *See Regents of the Univ. of Cal. v. Credit Suisse First Boston*, 482 F.3d 372 (5th Cir. 2007) ("*Enron*"). Recognizing that The Regents stated valid claims under the test formulated by the SEC, and adopted by the Ninth Circuit in *Simpson*, 452 F.3d 1040, the Fifth Circuit nonetheless reversed — ruling that the claims failed under the Eighth Circuit's competing standard stated in *In re Charter Commc'ns., Inc.*, 443 F.3d 987 (8th Cir. 2006), the decision presently under review.

The *Enron* panel majority wrote that "the Eighth and Ninth Circuits have split with respect to the scope of primary liability for secondary actors" who engage in conduct designed to mislead investors. *Enron*, 482 F.3d at 386. The panel majority acknowledged: "The district court adopts a rule advocated by the Securities and Exchange Commission ('SEC') . . . under which primary liability attaches to anyone who engages in a 'transaction whose principal purpose and effect is to create a false appearance of revenues.'" *Id.* But the Fifth Circuit rejected that test: "We agree with the Eighth Circuit that the SEC's proposed test . . . is too broad to fit within the contours of §10(b)." *Id.* at 386-87. "The Eighth Circuit, unlike the Ninth," the Fifth Circuit majority explained, has taken this Court's "decisions collectively to mean that '"deceptive" conduct involves either a misstatement or a failure to disclose by one who has a duty to disclose.'" *Id.* at 388 (quoting *Charter*, 443 F.3d at 990). Thus, though Enron, as an issuer of securities, was under a duty to issue truthful financial statements, the Fifth Circuit held that its bankers were free to engage in whatever deceptive practices they pleased — so long as they *said* nothing about it. *See id.*

The Regents' petition for certiorari in that case, in which the Fifth Circuit followed the decision below in this proceeding to terminate the *Enron* class action, *see Enron*, 482 F.3d

at 386-88, currently is pending before this Court as *The Regents of the Univ. of Cal. v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, No. 06-1341, *petition for cert. filed* (Apr. 5, 2007).

The decision in this case is apt to be critical to claims of The Regents and other victims of the Enron fraud. The Regents as Lead Plaintiff in the *Enron* litigation, and the class of investors that it was appointed to represent, obviously have a strong interest in ensuring that this Court adequately considers the implications of its decision in this case for other cases that — like *Enron* — involve complex fraud schemes. Moreover, the facts in *Enron* show that a clear line can be drawn between aiding-and-abetting liability and primary liability based on deliberately deceptive conduct designed to mislead investors.

THE ENRON FRAUD

The Regents' *Enron* class action arises out of the worst securities fraud in recent history, and demonstrates the difference between conduct that merely aids or abets another's wrongdoing, and conduct that is itself deliberately deceptive.

Thousands of investors lost billions of dollars in an acknowledged fraud that produced many criminal and regulatory proceedings, investigations, and hearings, all documenting massive financial wrongdoing. But Enron's bankruptcy, the collapse of its accountants, limited insurance, and government seizure of key insiders' assets, all appeared to doom the victimized investors to a minimal recovery in their §10(b)/Rule 10b-5 civil class-action suit — except for claims the investors asserted against certain large banks (the "Banks"), which had used deceptive devices and contrivances to hide Enron's debt and fabricate phony financial results in a deliberate scheme to defraud Enron investors.

The Regents alleged the Banks reaped huge profits by engaging in the scheme in which they:

- structured contrived financial transactions to falsify Enron's financial statements (generating fake profits and hiding billions of dollars of debt);
- sold billions in new Enron securities to the public (via prospectuses and circulars containing the falsified financial statements), thereby raising the fresh funds required to keep the Enron Ponzi scheme going; and
- had their securities analysts recommend Enron's stock via false analyst reports. This conduct inflated Enron's securities until the truth came out during 2001, causing the securities' prices to plummet and become worthless.[8]

The *Enron* district court, relying on The Regents' complaint and on briefs submitted by the SEC, upheld the factual adequacy and legal sufficiency of allegations that the Banks violated §10(b) by engaging in the fraudulent scheme.[9] Over the next five years, the district court refined its rulings regarding scheme liability to "tighten" the standard and require that each bank used a deceptive act or contrivance — reflecting new decisions,[10] and an SEC *amicus curiae* filing in

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[8] *See Enron*, 235 F. Supp. 2d at 613-14, 631, 633-37 (noting The Regents' allegation that "[i]n 2001, matters at Enron began to fall apart" and describing events leading to Enron's December 2, 2001, bankruptcy); *Enron*, 310 F. Supp. 2d at 827, 832, 836 (same). The Regents' pension fund, containing retirement savings of nearly 500,000 present and former employees of the University of California system, lost more than $140 million in the collapse of Enron's stock. *See Enron*, 206 F.R.D. at 454.

[9] The pleading satisfied all of the falsity and scienter pleading requirements imposed by both Fed. R. Civ. P. 9(b) and the 1934 Act §21D(b), 15 U.S.C. §78u-4(b), as to Merrill Lynch and Credit Suisse. *See Enron*, 310 F. Supp. 2d at 827-30; *Enron*, 235 F. Supp. 2d at 613-707.

[10] The district court relied on Judge Kaplan's extensive discussion of the relevant law in *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 504 (S.D.N.Y. 2005):

> The defendants' argument that they were at most aiders and abettors of a program pursuant to which Parmalat made misrepresentations on its financial statements misses the mark. The transactions in

Simpson, 452 F.3d 1040, supporting scheme liability. The district court ultimately adopted the SEC's test for scheme liability.[11]

The Regents' counsel analyzed millions of documents and took hundreds of depositions, and Enron's court-appointed Bankruptcy Examiners' investigations detailed the Banks' "knowing participation" in the fraud.[12] In 2006, certain banks settled the fraud claims against them for $6.6 billion, stipulating to a settlement class.[13]

> which the defendants engaged were by nature deceptive. They depended on a fiction, namely that the invoices had value. It is impossible to separate the deceptive nature of the transactions from the deception actually practiced upon Parmalat's investors. Neither the statute nor the rule requires such a distinction.

[11] *Enron*, 2006 U.S. Dist. LEXIS 43146, at *165-*173. Accordingly, in order for scheme liability to exist, the district court required that the defendant *commit a deceptive act*. For example:

> Lead Plaintiff must allege specific details that show that a structure of the entity or a transaction that was created by Barclays was inherently deceptive *and that Barclays used and employed it to deceive investors,* not that Enron, its officers and accountants subsequently used the entity improperly to cook its books, or that Barclays engaged in acts, practices, or a course of business that operated as a fraud or deceit upon any person in connection with the purchase or sale of an Enron security.

In re Enron Corp. Sec. Litig., No. H-01-3624, 2006 U.S. Dist. LEXIS 88121, at *21-*22 (S.D. Tex. Dec. 4, 2006).

[12] Third Interim Report of Neal Batson, court-Appointed Examiner at 82 ("Merrill Lynch had actual knowledge of the wrongful conduct in these transactions . . . ."); Final Report of Neal Batson, court-Appointed Examiner at 75 ("CSFB had actual knowledge of the wrongful conduct in these transactions . . . ."); Third Interim Report of Neal Batson, Court-Appointed Examiner at 66 ("Barclays had actual knowledge of the wrongful conduct in these transactions . . . .").

[13] The settlements were: Citibank — $2.0 billion, J.P. Morgan Chase — $2.2 billion, and CIBC — $2.4 billion. Other settlements brought the total to $7.3 billion. The total damages exceed $40 billion.

In July 2006, after considering expert testimony and with the benefit of a well-developed evidentiary record, the district court certified for trial a class of purchasers of Enron's publicly traded securities. *Enron*, 2006 U.S. Dist. LEXIS 43146; *Enron*, 236 F.R.D. 313. With trial scheduled for April 16, 2007, however, the Fifth Circuit accepted the remaining Banks' Rule 23(f) appeal challenging class certification on the ground that they could not be liable under §10(b). *Enron* Cert. Pet. Appx. at 679a-680a. Then, less than 30 days before trial, a fractured Fifth Circuit panel reversed. *See Enron*, 482 F.2d 372.

Two judges ruled, over vigorous objections from Judge James L. Dennis (*see id.* at 394-407), that (i) the Banks could not be liable under §10(b)/Rule 10b-5 for engaging in a scheme to defraud Enron's shareholders because they made no false statements; thus (ii) no class-wide presumption of reliance under *Basic Inc. v. Levinson*, 485 U.S. 224 (1988), was available; and therefore (iii) no class may be certified. *Enron*, 482 F.3d at 385-94. The majority acknowledged that its decision directly conflicted both with the Ninth Circuit's decision in *Simpson*, 452 F.3d 1040, and with the SEC's position.[14]

The *Enron* majority acknowledged this Court's admonition in *Central Bank* that "[t]he absence of §10(b) aiding and abetting liability *does not mean that secondary actors in the securities markets are always free from liability under the securities Acts.*" *Central Bank N.A. v. First Interstate Bank N.A.*, 511 U.S. 164, 191 (1994); *see Enron*, 482 F.3d at 386. But the lower courts had generated a Circuit "split" on the "the scope of primary liability for secondary actors" (*id.* at 386), with the Ninth Circuit holding in *Simpson*, 452 F.3d at 1048, that a defendant may be "liable as a primary violator of §10(b)

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[14] *Enron*, 482 F.3d at 385-90. The majority also implicitly rejected the views of the Attorneys General of 30 states who had filed an *amicus curiae* brief supporting scheme liability. *See Amicus Curiae* Brief of the State Attorneys General, filed in *Enron*.

for participation in a 'scheme to defraud,'" if it "engaged in conduct that had the principal purpose and effect of creating a false appearance of fact in furtherance of the scheme," while the Eighth Circuit held in *Charter*, 443 F.3d at 992, that "any defendant who does not make or affirmatively cause to be made a fraudulent misstatement or omission, or who does not directly engage in manipulative securities trading practices, is at most guilty of aiding and abetting and cannot be held liable under §10(b) or any subpart of Rule 10b-5."

The SEC's position was that §10(b)'s text prohibits, "within the rubric of engaging in a deceptive act, engaging in a transaction whose principal purpose and effect is to create a false appearance of revenues," drawing a clear distinction between primary and secondary liability: "Any person who directly or indirectly engages in a manipulative or deceptive act as part of a scheme to defraud can be a primary violator of Section 10(b) and Rule 10b-5(a); any person who provides assistance to other participants in a scheme but does not himself engage in a manipulative or deceptive act can only be an aider and abettor."[15]

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[15] Brief of the SEC as *Amicus Curiae* in *Simpson, supra* n.7, at 16-18; *see Simpson*, 452 F.3d at 1048. Deference is due the SEC's interpretation. *See SEC v. Zandford*, 535 U.S. 813, 819-20 (2002); *Nat'l Cable & Telecommc'ns. Ass'n v. Brand X Internet Servs.*, 545 U.S. 967, 980 (2005); *Chevron, U.S.A., Inc. v. NRDC*, 467 U.S. 837, 844 (1984); *Auer v. Robbins*, 519 U.S. 452, 462-63 (1997). As the district court explained in *Enron*, 2006 U.S. Dist. LEXIS 43146, at *165, quoting the SEC *Amicus Curiae* brief:

> "[D]eceptive acts under Section 10(b) include conduct beyond the making of false statements or misleading omissions, for facts effectively can be misrepresented by action as well as words. For example, if an investment bank falsely states that a client company has sound credit, there is no dispute that it can be primarily liable. If the bank creates an off-balance-sheet sham entity that has the purpose and effect of hiding the company debt, it has achieved the same deception, and liability should be equally available."

Acknowledging the SEC's view supports scheme liability, so that primary liability attaches to anyone who engages in a "'*transaction whose principal purpose and effect is to create a false appearance of revenues*,'" *Enron*, 482 F.3d at 386, the *Enron* majority nevertheless concluded "[w]e agree with the Eighth Circuit that the SEC's proposed test . . . is too broad to fit within the contours of §10(b)." *Id.* at 386-87.

"Presuming plaintiffs' allegations to be true,"[16] the *Enron* majority acknowledged The Regents had alleged: (i) that the Banks entered into "transactions that allowed Enron . . . to take liabilities off its books temporarily and to book revenue from the transactions when it was actually incurring debt [and] . . . these transactions . . . allowed Enron to misstate its financial condition" — which "gave a misleading impression of the value of Enron securities that were already on the market"; (ii) "that the banks knew exactly why Enron was engaging in seemingly irrational transactions";[17] and (iii) that the "banks intended to profit by helping the [Enron] executives maintain [the] illusion" of revenues — "inflating their stock price" — all the while knowing that "Enron was engaged in a long-term scheme to defraud investors . . . by inflating revenue and disguising risk and liability through its . . . transactions with the banks." *Enron*, 482 F.3d at 377.

The Banks' conduct was inherently deceptive. They structured and engaged in non-arm's-length transactions with Enron involving sham entities. These transactions, including fake commodity and energy trades, had no actual business purpose, but rather were designed solely to get cash to Enron while disguising loans to conceal Enron's debt, or to create fictitious operating revenues or earnings. These were "financial statement" transactions, *i.e.*, "structured finance" deals, intended to directly distort Enron's financial statements, not ordinary

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[16] *Enron*, 482 F.3d at 386.

[17] *Enron*, 482 F.3d at 376-77, 391.

arm's-length commercial transactions later misaccounted for by Enron. The Banks' documents admit the deals were designed to "*raise disguised debt*" and provide "*off-balance sheet parking lots*" for distressed assets, that the Banks had received *secret oral guarantees*, that the Banks "*will be taken out*" or the deal will "*unwind*," and that the contrived transactions were "*servicing*" Enron's "*particular accounting needs*," which "*had great value in their stock price.*"[18]

Enron's former CFO Andrew Fastow, after admitting his crimes, testified and laid it out. He said "[i]n many instances, the banks primarily *devised the financial structures.*" "In many cases, *the banks brought us these structures*, and we executed the transactions with the banks." 8R:36721 (Fastow Decl., ¶6); COR01758-59 (Fastow Depo.). They "worked together, intentionally and knowingly, *to engage in transactions that would affect Enron's financial statements.*" 8R:36722 (Fastow Decl., ¶7). According to Fastow:

> When you boil it all down, Enron wanted to paint a picture of itself to the outside world that was different from the reality inside Enron. *And these structured financial transactions, along with other things that Enron did, created that deception.*

COR01788 (Fastow Depo.); *see also* COR01756-58 (Fastow Depo.). Fastow elaborated:

> Well, Enron had a problem in that its — the results it would otherwise have published from just its business operations were usually insufficient in order for Enron to

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[18] COR01177 (Ex. 50028); COR01078 (Ex. 11664); COR00020 (ML Summary Judgment Ex. 5). Documents cited herein appear in the Record of Appeal ("R") before the Fifth Circuit in the *Regents v. Credit Suisse First Boston*, No. 06-20856, and are cited by giving the volume and the Fifth Circuit page number, *e.g.*, "8R:36721." In addition, documents cited as "COR" refer to documents submitted and attached to Appellees' Motion to Correct Omissions from the Transmitted Record also filed in *Regents v. Credit Suisse First Boston*, No. 06-20856 (5th Cir.).

> maintain its investment grade credit rating or to meet its earnings targets.
>
> And we were looking [*sic*] with banks who could help us solve this problem, meaning doing transactions that would, as we described it internally, *fill the gap between what was really happening inside Enron and what — the way we wanted Enron to appear to the outside world.*

COR01754 (Fastow Depo.). These contrivances and subterfuges reportedly deceived Enron's auditors, who testified that had they not been misled by the Banks, they would not have approved accounting for numerous transactions or provided audit certifications.[19]

But the *Enron* majority concluded that, *even assuming this was all true*, "the banks only aided and abetted that fraud," and the "banks' participation in the transactions, *regardless of the purpose and effect of those transactions*, did not give rise to primary liability under §10(b)." *Enron*, 482 F.3d at 386, 390. To reach this result, the Fifth Circuit majority read this Court's precedents as "*narrowly defining the scope of 'fraud' in the context of securities*" (*id.* at 387), and it opted for a "*[s]trict* construction of §10(b)" and a "*limited interpretation of the words of §10*," to preclude liability under the rubric of "deceptive acts" or "scheme." *Id.* at 392-93.

With understatement, the majority noted the Banks' conduct was "'hardly praiseworthy,'" *id.* at 394 n.2, admitting that its "interpretation of §10(b) could have gone in a different direction and . . . established liability for the actions the banks are alleged to have undertaken . . . [as] one of our sister circuits — the Ninth [Circuit] — believes that it did." *Id.* at 393. Acknowledging that "former Enron shareholders who have lost billions of dollars in a fraud" would find the result at odds "with notions of justice and fair play," the Fifth

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[19] Arthur Andersen ("AA") auditors, Thomas Bauer, Michael Odom, Patty Grutzmacher and John Stewart all testified that had they known the truth about the transactions, AA would not have approved the accounting.

Circuit denied the victims of this notorious fraud *even a chance to prove their §10(b) case* on the merits — so as to avoid "opening the floodgates for nearly unlimited and frequently unpredictable liability for secondary actors in the securities markets." *Id.*

Styled a "concurrence," Judge Dennis's opinion is in substance a dissent from the *Enron* majority's analysis on these points. He disagreed with "the majority's cramped interpretation of the statutory language of section 10(b)," that "immunizes a broad array of undeniably fraudulent conduct from civil liability under Section 10(b), effectively giving secondary actors license to scheme with impunity, so long as they keep quiet." *Id.* at 394. Recognizing that "the majority's [decision] is strictly a question about the substantive reach of Section 10(b)" (*id.* at 397), he stated its "narrow interpretation of Section 10(b)" ignored this Court's mandate to construe "the disputed statutory language 'not technically and restrictively, but flexibly to effectuate its remedial purposes.' *SEC v. Zandford*, 535 U.S. 813, 819 (2002)." *Enron*, 482 F.3d at 399-400. Judge Dennis concluded (*id.* at 400-01):

> I see no basis for the majority opinion's strict, narrow reading, and I agree with the district court, the Ninth Circuit [in *Simpson*], Judge Kaplan [in *Parmalat*], and the SEC that Section 10(b)'s prohibition on directly or indirectly employing any "deceptive device or contrivance" can reach secondary actors who, with scienter, engage in fraudulent transactions that are used to inflate an issuer's financial results. *See Simpson*, 452 F.3d at 1050 ("If a defendant's conduct or role in an illegitimate transaction has the principal purpose and effect of creating a false appearance of fact in the furtherance of a scheme to defraud, then the defendant is using or employing a deceptive device within the meaning of §10(b)"); *Enron*, 2006 U.S. Dist. LEXIS 43146, at *167-74 (adopting SEC view "that a deceptive act includes a transaction whose principal purpose and effect is to create a false appearance of revenues, which can be

accomplished by acts as well as by words") (internal quotation marks omitted); *Parmalat*, 376 F. Supp. 2d at 502-03.

A central question, of course, is whether the words "use or employ . . . any manipulative or deceptive device or contrivance" in §10(b) may encompass the use or employment of a "scheme . . . to defraud" prohibited by Rule 10b-5(a) — thus creating liability for engaging in a scheme to defraud (assuming scienter and all the other elements of §10(b) liability are present) — or whether they are limited to misstatements of fact. The *Enron* majority chose the latter interpretation, as "the rule may not be broader than the statute" and the "district court's definition of 'deceptive device' [to include fraudulent-scheme liability] thus sweeps too broadly." *Enron*, 482 F.3d at 390. Yet, holding that §10(b)'s language is to be interpreted and applied in a "flexible" manner to effectuate its "remedial purposes" (not "narrowly" or in a "strict" manner as the *Enron* majority said), *Zandford* also expressly states "*[t]he scope of Rule 10b-5 is coextensive with the coverage of §10(b)*," 535 U.S. at 816 n.1, foreclosing any conclusion that Rule 10b-5's "scheme to defraud" language is beyond the scope of §10(b).[20]

The *Enron* majority claimed that the need for "certainty and predictability" for "good-faith financial professionals who are attempting to avoid liability" justified its decision. *Enron*, 482 F.3d at 386, 392. *Amicus* agrees that "'certainty and predictability'" are desirable. *Central Bank*, 511 U.S.

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[20] The SEC had alleged the defendant "'engaged in a *scheme to defraud*,'" via a "complaint describ[ing] a *fraudulent scheme*" and "was . . . able to carry out his *fraudulent scheme without making an affirmative misrepresentation*." *Id.* at 820. His "*conduct without more*" was held a violation of §10(b), as "neither the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security in order to run afoul of the Act." *Id. Zandford* supports liability for knowingly engaging in a fraudulent scheme, even if no affirmative misstatement is made.

at 188 (quoting *Pinter v. Dahl*, 486 U.S. 622, 652 (1988)). Market actors like banks should know that if they use or employ a deceptive device or contrivance, while engaging in a scheme to defraud, they will certainly and predictably face liability under §10(b). Such certainty and predictability would further the deterrent purpose of the law, preventing fraud, as banks (and other market participants) are disincentivized to engage in misconduct. Investors are entitled to certainty and predictability too — they should be able to invest their capital in our markets knowing that fraudulent schemes are unlawful and that if they are victimized by deliberately deceptive misconduct they will at least have access to the federal courts to pursue a remedy. That is the kind of certainty and predictability we need to assure the integrity of our markets and to protect investors — the real purpose of our securities laws.

The tortured reasoning of the decision below and of the *Enron* majority are an injustice to the victims of fraud, setting an incorrect and dangerous precedent that misinterprets §10(b) and Rule 10b-5, misapplies *Central Bank*, ignores *Zandford*, and undermines the broad protections that §10(b)/Rule 10b-5 were meant to provide America's investors from deceptive devices and contrivances — including fraudulent schemes.

SUMMARY OF ARGUMENT

The decision below conflicts with the position of the SEC, adopted by the Ninth Circuit in *Simpson*, and by the *Enron* district court. It is, moreover, wrong. When it followed the decision below in this case, the Fifth Circuit majority in *Enron* admitted that the SEC disagreed with its "narrow" and "strict construction" of §10(b), and that its decision *"could have gone in a different direction,"* had it been true to §10(b)'s text. *Enron*, 482 F.3d at 387, 393. Applying that text, this Court's precedents strongly support scheme liability. *See, e.g.*, *Zandford*, 535 U.S. at 820; *Affiliated Ute Citizens v. United States*, 406 U.S. 128, 151-53 (1972); *Superintendent of Ins. v. Banker's Life & Casualty Co.*, 404 U.S. 6 (1971).

Circuit court decisions support scheme liability.[21] So do many recent district court decisions.[22] Those who engage in schemes to defraud investors by executing sham transactions to falsify a company's financial results or hide its debt properly face primary liability under §10(b) and Rule 10b-5.

ARGUMENT

I. THE DECISION BELOW AND *ENRON* DEPART FROM THE STATUTORY TEXT

Liability exists under §10(b) for any person who (with scienter) engages in falsifying the financial statements of a public company, whether or not that person independently

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[21] *See Cooper v. Pickett*, 137 F.3d 616, 620 (9th Cir. 1997) *(scheme liability exists* "as long as each defendant committed a . . . deceptive act in furtherance of the scheme"); *SEC v. U.S. Envtl., Inc.*, 155 F.3d 107, 112 (2d Cir. 1998) (defendant a primary violator if he "'*participated in the fraudulent scheme*;'" noting "lawyers, accountants, and banks who engage in fraudulent or deceptive practices at their clients' direction [are] primary violator[s]"); *Competitive Assocs., Inc. v. Laventhol, Krekstein, Horwath & Horwath*, 516 F.2d 811, 814-15 (2d Cir. 1975) ("Not every violation of the anti-fraud provisions of the federal securities law can be, or should be, forced into a category headed 'misrepresentations' or 'non-disclosures.' *Fraudulent devices, practices, schemes, artifices and courses of business are also interdicted by the securities laws.*"); *Blackie v. Barrack*, 524 F.2d 891, 904 n.19 (9th Cir. 1975) ("Rule 10b-5 liability is not restricted solely to isolated misrepresentations or omissions; *it may also be predicated on a 'practice, or course of business which operates. . . as a fraud . . . .*'"); *Richardson v. MacArthur*, 451 F.2d 35, 40 (10th Cir. 1971) *("[A]ll fraudulent schemes in connection with the purchase and sale of securities are prohibited.").*

[22] *See, e.g., Parmalat*, 376 F. Supp. 2d at 504; *In re Lernout & Hauspie Sec. Litig.*, 236 F. Supp. 2d 161, 173 (D. Mass. 2003); *In re Initial Pub. Offering Sec. Litig.*, 241 F. Supp. 2d 281, 381-82 (S.D.N.Y. 2003); *Quaak v. Dexia, S.A.*, 357 F. Supp. 2d 330, 342 (D. Mass. 2005); *In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 336-37 (S.D.N.Y. 2004); *SEC v. Hopper*, No. H-04-1054, 2006 U.S. Dist. LEXIS 17772, at *34-*42 (S.D. Tex. Mar. 24, 2006).

makes a false statement himself, so long as the actor uses or employs a manipulative or deceptive device or contrivance. This is the test mandated by the express language of §10(b) and Rule 10b-5.

The standard applied by the Eighth Circuit below, and by the Fifth Circuit in *Enron*, departs radically from the statutory text's natural meaning. The *Enron* majority even chided the district court in that case for construing §10(b)'s use of the word "deceptive" in line with its ordinary meaning, explaining that it is only "*by ascribing natural, dictionary definitions to the words of the [statute and] rule, that the district court and likeminded courts have gone awry.*" *Enron*, 482 F.3d at 387. The *Enron* majority ruled that "defining 'deceptive' by referring to the same dictionary the [Supreme] Court used to define 'device,' a [sic] — the approach taken by the court in *Parmalat*, 376 F. Supp. 2d at 502, and approvingly cited by the district court . . . *is improperly to substitute the authority of the dictionary for that of the Supreme Court.*" *Enron*, 482 F.3d at 389.

Yet this Court holds that statutory language generally must be interpreted in accord with its *ordinary* meaning.[23] Section §10(b)'s words, in particular, must be accorded their "commonly accepted meaning." *Ernst & Ernst v. Hochfelder*, 425 U.S. 185, 198-99 (1976).

The Fifth and Eighth Circuits both misconstrue this Court's precedents concerning the term "deceptive." According to this Court's precedents, §10(b)'s prohibition of "*any manipulative or deceptive device or contrivance*" necessarily encompasses a "*scheme to defraud.*" This Court used *Webster's*

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[23] *Pasquantino v. United States*, 544 U.S. 349, 356 (2005) ("'When interpreting a statute, we must give words their ordinary or natural meaning.'"); *Smith v. United States*, 508 U.S. 223, 228 (1993) ("When a word is not defined by statute, we normally construe it in accord with its ordinary or natural meaning.").

International Dictionary (2d ed. 1934) to give content to §10(b)'s terms in *Hochfelder*, 425 U.S. at 188 & nn.20-21. *Hochfelder* referred to dictionary definitions of §10(b)'s words to state that a "device" is "'[t]hat which is devised, or formed by design; a contrivance; an invention; project; *scheme; often, a scheme to deceive; a stratagem; an artifice.*'" *Id.* at 199 n.20. The Court also found that a "contrivance" means "'a scheme, plan, or artifice,'" again quoting *Webster's. Id.; see also Aaron v. SEC*, 446 U.S. 680, 696 n.13 (1980). Clearly, a "scheme" to deceive investors is encompassed in the express language of §10(b), according to the natural, commonly understood meaning of the words of §10(b). Thus Rule 10b-5 — adopted by the SEC to implement §10(b) — properly makes it unlawful for any person "*directly or indirectly* . . . to employ *any* device, *scheme*, or artifice *to defraud*," as well as "*[t]o make any untrue statement[s]*," or to "*engage in any act, practice, or course of business which operates . . . as a fraud or deceit upon any person.*" 17 C.F.R. §240.10b-5.

The Fifth Circuit concluded in *Enron* that "*what the banks are alleged to have done, namely engage in transactions elsewhere that gave a misleading impression* of the value of Enron securities that were already on the market," is beyond §10(b)'s reach. *Enron*, 482 F.3d at 391. The Banks' conduct, executed with the purpose and effect of deliberately creating "a misleading impression of the value of Enron securities" (*id.*), was held not "deceptive" within the meaning of a statute that by its express terms was designed to reach "any manipulative or deceptive device or contrivance" employed by "any person," whether "directly or indirectly." 15 U.S.C. §78j(b). The majority frankly acknowledged that nothing in §10(b) compelled this odd result (*Enron*, 482 F.3d at 393):

> We acknowledge that the courts' interpretation of §10(b) could have gone in a different direction and might have established liability for the actions the banks are alleged

> to have undertaken. Indeed, one of our sister circuits — the Ninth [Circuit] — believes that it did.

Nothing in this Court's decisions suggests that courts may ignore the ordinary meaning of the statute's words to immunize those who deliberately engage in deceptive acts or use contrivances in scheming to mislead investors. Quite the contrary, *Central Bank* held that "the *text* of the 1934 Act does not itself reach those who aid and abet a §10(b) violation," and that this "conclusion resolves the case." 511 U.S. at 177. If the statutory text thus controls then those who engage in deliberately deceptive acts as part of a scheme to mislead investors must be primary violators of §10(b), not mere aiders and abettors.

Yet the *Enron* majority and the court below both rejected §10(b)'s plain meaning. The pertinent text states: "It shall be unlawful for any person, directly or indirectly . . . to use or employ . . . any . . . deceptive device or contrivance." 15 U.S.C. §78j(b). These words cannot sensibly be limited to prohibiting only misstatements. Even under the common law — which the securities laws were meant to enlarge — deception included misleading conduct and active concealment.[24] The common law of deceit and of market manipulation contemporaneous with the 1934 Act's enactment clearly incorporated this principle.[25] Dean William J. Prosser explained:

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[24] The common law of fraud and deceit saw deception in *any conduct* designed to mislead another: "The gist of the action is fraudulently producing a false impression upon the mind of the other party; and, if this result is accomplished it is unimportant whether the means of accomplishing it are words or acts of the defendants." *Stewart v. Wyoming Cattle Ranche Co.*, 128 U.S. 383, 388 (1888); *accord, e.g., United States v. Colton*, 231 F.3d 890, 899-900 (4th Cir. 2000) (following *Stewart*); *United States v. Brown*, 5 F. Supp. 81, 89 (S.D.N.Y. 1933), *aff'd*, 79 F.2d 321 (2d Cir. 1935); *Leonard v. Springer*, 64 N.E. 299, 301 (Ill. 1902).

[25] *See Brown*, 5 F. Supp. at 84-89; A.A. Berle, *Stock Market Manipulation*, 38 Colum. L. Rev. 393, 394-97 (1938); A.A. Berle, *Liability for Stock Market Manipulation*, 31 Colum. L. Rev. 264, 267-71 (1931).

> The representation which serves as the foundation for an action of *deceit may consist of words or conduct.* Any active concealment of the truth, *by words or conduct* creating a false impression or removing an opportunity to discover the facts, is treated as the equivalent of a representation that such facts are not true.

William J. Prosser, *Handbook of the Law of Torts* §86, at 720 (1st ed. 1941).[26] And this Court adheres to "the general rule that a common law term in a statute comes with a common law meaning absent anything pointing another way."[27]

Those who engage in transactions that are deceptive — both in the sense that they gave the false appearance of being

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[26] The *Restatement* is to the same effect: "'Misrepresentation' is used in this Chapter to denote not only words spoken or written but also any other conduct which amounts to an assertion not in accordance with the truth. Thus, words or conduct asserting the existence of a fact constitute a misrepresentation if the fact does not exist." *Restatement of Torts,* §525, cmt. b (1938); *accord Restatement (Second) of Torts* §525, cmt. b (1979). "A misrepresentation may be expressed by acts and conduct as well as in words. A falsehood may be expressed by deeds, acts, conduct, or artifice, as well as in words or assertions; deceptive conduct is equivalent to verbal misrepresentation. A misrepresentation may consist of a combination of conduct and concealment or conduct and language or solely of conduct." 37 C.J.S. *Fraud* §12 (2007).

[27] *Safeco Ins. Co. of Am. v. Burr*, No. 06-84, __ U.S. __, 2007 U.S. LEXIS 6963, at *20-*21 (U.S. June 4, 2007); *accord Neder v. United States*, 527 U.S. 1, 21-22 (1999). Given "the common-law roots of the securities fraud action," *Dura Pharms., Inc. v. Broudo,* 544 U.S. 336, 344 (2005), of course, "it would be highly inappropriate to construe the Rule 10b-5 remedy to be more restrictive in substantive scope than its common law analogs." *Sundstrand Corp. v. Sun Chem. Corp.,* 553 F.2d 1033, 1044 (7th Cir. 1977). "Indeed, an important purpose of the federal securities statutes was to rectify perceived deficiencies in the available common-law protections by establishing higher standards of conduct in the securities industry," *Herman & MacLean v. Huddleston,* 459 U.S. 375, 389 (1983), and private actions under §10(b), in particular, "are in part designed to add to the protections provided investors by the common law." *Basic,* 485 U.S. at 245 n.22.

something other than what they were, and in the sense that they were designed to (and did) effect a fraud on investors — should be liable under §10(b). *Enron* provides a clear case in point. The Banks were not only aware of the deception — they actively engaged in the deceptive transactions at its core and thereby committed an active misrepresentation of Enron's condition, and concealment of its debt. Thus, *in effect*, the Banks made a false representation. And, because their deception was aimed squarely at the market, the Banks should be found primarily liable to market participants, even though the deception was communicated to the market through Enron. This Court should not adopt a rule that protects them from liability.

Opinions of the Ninth Circuit in *Simpson*, Judge Harmon in *Enron*, and Judge Kaplan in *Parmalat*, all show that courts can draw a careful distinction between primary and secondary liability in this context. In *Parmalat*, Judge Kaplan dealt with secondary actors (banks) engaging in conduct similar to that at issue in *Enron*:

> In this case, the complaint alleges that the banks' actions in connection with the relevant transactions actually and foreseeably caused losses in the securities markets. The banks made no relevant misrepresentations to those markets, but they knew that the very purpose of certain of their transactions was to allow Parmalat to make such misrepresentations. In these circumstances, both the banks and Parmalat are alleged causes of the losses in question. So long as both committed acts in violation of statute and rule, both may be liable.
>
> This analysis is not an end run around *Central Bank*. If a defendant has committed no act within the scope of Section 10(b) and Rule 10b-5 — as in fact was the case in *Central Bank* — then liability will not arise on the theory that that defendant assisted another in violating the statute and rule. But where, as alleged here, a financial institution enters into deceptive transactions as

> part of a scheme in violation of Rule 10b-5(a) and (c) that causes foreseeable losses in the securities markets, that institution is subject to private liability under Section 10(b) and Rule 10b-5.

Parmalat, 376 F. Supp. 2d at 509-10.

To reject this view requires the statute's words to be reinterpreted: "Directly or indirectly" must be reinterpreted to mean only "directly," since only the maker of a false statement *(i.e.,* the "direct" actor) can be liable. "Use or employ" — the verbs the statute uses in making it unlawful to "use or employ any device or contrivance" — plainly suggest conduct or the operation of a scheme, not just the making of misrepresentations. The plain words "device or contrivance" contradict any limitation on the thing that is "used or employed" to *statements* of fact. Yet the decision below in this case requires reading §10(b) as follows: "It shall be unlawful for any person, directly *[not indirectly] to make [not use or employ]* . . . any deceptive *statement [not device or contrivance].*"

The *Enron* majority said it departed from a natural reading of the statute's words (*Enron*, 482 F.3d at 387), because "[t]he Supreme Court has defined 'device' by referring to a dictionary but has pointedly refused to define 'deceptive' in any way except through caselaw," which the majority construed as deviating widely from the ordinary meaning of what is deceptive. *Id.* at 389. Specifically, the majority construed this Court's insider-trading decisions, *Chiarella v. United States*, 445 U.S. 222, 234-35 (1980), and *United States v. O'Hagan*, 521 U.S. 642, 655 (1997), as creating a general rule that however deceptive a misleading device or contrivance may be in fact, even an inherently misleading "device, such as a scheme, is not 'deceptive' unless it involves breach of some duty of candid disclosure." *Enron*, 482 F.3d at 389. "Enron had a duty to its shareholders," it reasoned, "but the banks did not." *Id.* at 390. Thus, the Banks' conduct in

engaging in contrived transactions to hide Enron's debt and inflate its earnings *in order to mislead investors* could not be deemed "deceptive" as that term is used in §10(b).

The *Enron* majority's opinion misreads this Court's precedents. *Chiarella's* discussion of duty *assumes a claim based on a failure to speak:* "This case concerns the legal effect of the petitioner's silence." 445 U.S. at 226. In an insider-trading case like *Chiarella*, the claim of fraud is grounded in an insider's failure to make required disclosures in connection with a specific securities transaction. *Chiarella* and *O'Hagan* did not at all address whether deliberately deceptive *conduct* can qualify as a deceptive device under §10(b).

"Silence, absent a duty to disclose, is not misleading under Rule 10b-5," this Court observed in *Basic,* 485 U.S. at 239 n.17. In contrast, this case and *Enron* involve the legal effect not of third parties' silence, but of their deceptive conduct. The investors' claims in both cases are grounded not in alleged silence in the face of a duty to speak, but upon the fact that the defendants deliberately engaged in *conduct* to mislead investors by affirmatively taking steps to distort an issuer's financial statements — conduct which the *Enron* majority recognized actually inflated the value of Enron's securities trading in the market.[28]

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[28] *Enron*, 482 F.3d at 382-83. The relevant duty thus is the duty not to engage in conduct that violates the statute, which forbids *"any person"* from engaging in the specified "manipulative or deceptive" conduct. As the *Enron* district court noted:

> [T]he requisite duty is not a duty to disclose, but . . . "the duty not to engage in a fraudulent 'scheme' or 'course of conduct' [that] could be based primarily on an omission."

Enron, 2006 U.S. Dist. LEXIS 43146, at *102. The statute prohibits *"any person"* from employing "any manipulative or deceptive device or contrivance" "in connection with the purchase or sale of any security." 15 U.S.C. §78j(b). The statute by its very plain terms reaches *any person* engaged in "a scheme to misrepresent the publicly reported revenues of a company" because "all participants may be viewed as having acted in

Section 10(b) does not even speak in terms of statements and omissions. It obviously was designed to cover deceptive conduct — as well as deceptive statements and omissions — by making it unlawful "for any person, directly or indirectly, . . . to use or employ . . . any manipulative or deceptive device or contrivance" proscribed by the SEC. 15 U.S.C. §78j(b). Rule 10b-5 addresses misleading statements and omissions in subsection (b), but in subsections (a) and (c) it imposes a duty not to engage in devices or schemes (subsection (a)) or acts, practices or courses of business conduct (subsection (c)) that would "operate as a fraud" on any person. To say that there can be no fraud absent a duty to speak would collapse (a) and (c) into Rule 10b-5(b)'s rule against misleading statements and omissions.

II. THE LIABILITY STANDARD FRAMED BY THE SEC AND ADOPTED IN *SIMPSON* COMPORTS WITH STATUTORY TEXT AND WITH THIS COURT'S PRECEDENTS

While the decision below, and the *Enron* majority, both impermissibly distort §10(b)'s language to do away with scheme liability, the SEC's carefully crafted test, adopted by the Ninth Circuit in *Simpson* and by the district court in *Enron*, is wholly consistent with this Court's decision in *Central Bank*. Aiding-and-abetting liability was barred in *Central Bank* because the words "aid and abet" are not in the statute or rule, and also because aiding-and-abetting liability might be imposed on one who merely assisted in some way another person's violation, without doing anything manipulative or deceptive itself. An aider and abettor could be held liable for violating §10(b) despite doing nothing prohibited by §10(b). By contrast, the prohibition against engaging in

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connection with the purchase or sale of securities." *Simpson*, 452 F.3d at 1051. In *Enron*, in *Parmalat*, the "banks' actions in connection with the relevant transactions actually and foreseeably caused losses in the securities markets." *Parmalat*, 376 F. Supp. 2d at 509.

deceptive conduct or a scheme to defraud flows from the statute's text, imposing liability when an actor, with scienter, does something prohibited by §10(b): use or employ a manipulative or deceptive device or contrivance. Petitioner's theory of liability is true to *Central Bank* and to the controlling statute's words.

Central Bank did not immunize bankers from liability for engaging in complex securities frauds. It recognized: "The absence of §10(b) aiding and abetting liability *does not mean that secondary actors in the securities markets are always free from liability under the securities Acts. . . . In any complex securities fraud, moreover, there are likely to be multiple violators . . . .*" *Central Bank*, 511 U.S. at 191. A scheme often will involve multiple actors, and investors are entitled to allege "that a group of defendants acted together to violate the securities laws, as long as each defendant committed a manipulative or deceptive act in furtherance of the scheme." *Cooper*, 137 F.3d at 624.[29]

Central Bank noted its reasoning was "confirmed" by the fact that to accept the plaintiffs' aiding-and-abetting argument would impose §10(b) liability "when at least one element critical for recovery" was absent, *i.e.*, reliance on the defendant's conduct. "Were we to allow the aiding and abetting action proposed in this case, the defendant could be liable

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[29] In *Central Bank*, the defendant bank had no commercial relationships with the municipal entity involved, was not its investment bank, was not an underwriter of its securities, and issued no analyst reports about the issuer. It *took no affirmative act that could have affected the trading price of the municipal bonds in issue* — for which there was no trading market. Clearly, that is a significantly different fact pattern from the allegations against the Banks in *Enron*, which engaged in repeated transactions of an inherently deceptive nature with Enron, including contrivances, sham entities and secret no-loss/take-out guarantees — bogus transactions designed to directly distort Enron's financial statements as filed with the SEC and distributed to the investment community — all of which inevitably impacted the trading price of Enron's securities.

without any showing that the plaintiff relied upon the aider and abettor's statements or *actions*." *Central Bank*, 511 U.S. at 180. Allowing plaintiffs to "circumvent the reliance requirement would disregard the careful limits on 10b-5 recovery as mandated by our earlier cases." *Central Bank*, 511 U.S. at 180. This Court cited *Basic*, 485 U.S. 224, which held that reliance is satisfied if fraudulent acts affect the price at which securities trade. *See Central Bank*, 511 U.S. at 180.

But in this case, and in *Enron*, third parties' *deceptive conduct did operate to inflate* the prices of *publicly traded* securities. Indeed, the *Enron* majority acknowledged "the factual probability that the market relied on the banks' behavior and/or omissions," and that what the banks did was to "engage in transactions . . . that gave a misleading impression of the value of Enron securities that were already on the market." *Enron*, 482 F.3d at 383, 391. The reliance element is *satisfied* in a fraud-on-the-market case when securities trading in an open-and-developed market are thus affected. *See Basic*, 485 U.S. at 241-49; *see also Parmalat*, 376 F. Supp. 2d at 505-06.

A long line of this Court's decisions, moreover, recognizes that *deceptive conduct* violates §10(b). In *Superintendent of Ins.*, 404 U.S. 6, a *unanimous* Court upheld a complaint involving a "fraudulent scheme" involving the sale of securities, explaining: "*There certainly was an 'act' or 'practice' within the meaning of Rule 10b-5 which operated as 'a fraud or deceit' on Manhattan, the seller of the Government bonds.*" *Superintendent of Ins.*, 404 U.S. at 9. This Court emphasized:

> "We believe that §10(b) and Rule 10b-5 prohibit all fraudulent schemes in connection with the purchase or sale of securities, whether the artifices employed involve a garden type variety of fraud, or present a unique form of deception. Novel or atypical methods should not provide immunity from the securities laws."

Id. at 11 (quoting *A.T. Brod & Co. v. Perlow*, 375 F.2d 393, 397 (2d Cir. 1967)).

In *Affiliated Ute*, the Court observed that "the second subparagraph of the rule specifies the making of an untrue statement of a material fact and the omission to state a material fact," but held that "[t]he first and third subparagraphs are not so restricted." 406 U.S. at 152-53. Thus, the defendants violated Rule 10b-5 by engaging in *"a 'course of business' or a 'device, scheme, or artifice' that operated as a fraud,"* though they had never themselves said anything that was false or misleading. *Id.* at 153. "[T]he 1934 Act and its companion legislative enactments," this Court held, were designed "'to achieve a high standard of business ethics in the securities industry.'" *Id.* at 151. "Congress intended securities legislation enacted for the purpose of avoiding frauds to be construed 'not technically and restrictively, but flexibly to effectuate its remedial purposes.'" *Id.*

In *Hochfelder*, this Court noted that a manipulative or deceptive "device," by definition, includes "a scheme to defraud." *Hochfelder*, 425 U.S. at 189 n.20. A scheme, this Court elaborated in *Aaron*, is "'[a] plan or program of something to be done.'"[30] Indeed, a "scheme to defraud" encompasses any "plan designed or concocted for perpetrating a fraud." *Ballentine's Law Dictionary* 1142 (3d ed. 1969). It has long included any scheme to defraud investors by causing securities to trade at fraudulently inflated prices; when §10(b) was enacted such conduct already was an unlawful "scheme to defraud" under the mail-fraud statute.[31] Today it is called

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[30] *Aaron*, 446 U.S. at 696 n.13 ("Webster's International Dictionary (2d ed. 1934) defines . . . 'scheme' as '[a] plan or program of something to be done; an enterprise; a project; as a business *scheme*[, or a] crafty, unethical project . . . .'"). To "scheme" is "[t]o form plans or designs; to devise intrigue." *Webster's International Dictionary* 2234 (2d ed. 1934).

[31] In *Harris v. United States*, 48 F.2d 771 (9th Cir. 1931), for example, "[t]he fraudulent scheme charged . . . was one for the sale of [a mining

a "fraud on the market," actionable under §10(b). *See Basic*, 485 U.S. at 241-47; *Lipton v. Documation, Inc.*, 734 F.2d 740, 744-47 (11th Cir. 1984). Every person who intentionally engages in such a "scheme" to defraud by using a "manipulative or deceptive device or contrivance" is thus a primary violator of §10(b).

In *O'Hagan*, this Court held that liability under §10(b) does not require a defendant to speak, because §10(b) prohibits "'any manipulative or deceptive device or contrivance'" in contravention of SEC rules outlawing "any deceptive device," whether or not the defendant spoke. *O'Hagan*, 521 U.S. at 651.

In *Zandford*, 535 U.S. 813, this Court repeatedly cited with approval its seminal *"fraudulent scheme"* case, *Superintendent of Ins.*, and reversed dismissal, making the following key points:

- "The scope of Rule 10b-5 is coextensive with the coverage of §10(b) . . . ."
- "[N]either the SEC nor this Court has ever held that there must be a misrepresentation about the value of a particular security" to violate §10(b).
- Allegations that defendant *"engaged in a fraudulent scheme"* or "'*course of business' that operated as a fraud or deceit*" stated a §10(b) claim. *Zandford*, 535 U.S. at 816 n.1, 820-21.

Central Bank clearly — but merely — stands for the proposition that no aiding-and-abetting liability exists under the 1934 Act because neither §10(b) nor Rule 10b-5 contain "aiding and abetting" language. The decision in *Central*

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company's] corporate stock . . . by the manipulation of the price of the stock on the [stock exchanges] and the circulation of false reports concerning the mine through the mails." *Id.* at 774. "In fact, the whole scheme centered around the establishment of an alleged stock exchange value which is in fact wholly fictitious." *Id.* at 775; *see also Brown*, 5 F. Supp. at 84-89; Berle, *Stock Market Manipulation*, *supra* n.25, at 395-97.

Bank is *quite narrow*. By contrast, the language of §10(b) and Rule 10b-5 is broad.

That scheme liability survives *Central Bank* is confirmed by Congress's comprehensive revision of the 1934 Act in 1995, with the Private Securities Litigation Reform Act of 1995 ("PSLRA"), Pub. L. 104-67, 109 Stat. 737 (1995). Just a year after *Central Bank*, and its statement that "[i]n most complex cases there are likely to be multiple violators," 511 U.S. at 191, Congress substantially revised the law governing the §10(b) private right of action, including the rules for joint-and-several liability when multiple actors engage in a fraudulent scheme. 15 U.S.C. §78u-4(f). Congress provided that *proportionate liability* is the general rule, but that joint-and-several liability applies to all who either (i) make a false statement "with actual knowledge" of its falsity *or* (ii) otherwise *engage in "conduct* with actual knowledge of the facts and circumstances that make *the conduct . . . a violation of the securities laws*." 15 U.S.C. §78u-4(f)(10)(A)(ii). This *"conduct"* language would be superfluous if only the individual actor making a statement could be held liable under §10(b).

III. THE FACTS IN *ENRON* SHOW THAT A CLEAR DISTINCTION MAY BE DRAWN BETWEEN PRIMARY LIABILITY BASED ON DECEPTIVE CONDUCT AND MERE AIDING AND ABETTING

Enron's facts show that a clear distinction may be drawn between mere aiding and abetting and primary conduct designed to mislead. The fraud in that case consisted of hiding Enron's debt and executing sham transactions to falsify Enron's financial results. The Banks that contrived and executed those transactions to hide debt and to generate phony financial results engaged in conduct that was intended — by them — to mislead investors.

In *Enron* many of the bank transactions were completely illusory, often with secret, no-loss guarantees or take-out promises, devoid of any economic substance. Their *only* purpose was to distort Enron's financial statements. And they were executed by *major players in the securities markets. Enron* involves the alleged misconduct of banks — major actors in our nation's financial markets which *Central Bank* identified as secondary actors who "may be liable as primary violators under Rule 10b-5 . . . in any complex securities fraud [where] there are likely to be multiple violators." *Central Bank*, 511 U.S. at 191. The securities acts were passed in large part to remedy the misconduct of the Wall Street banks occurring in the 1920s, as documented by the Pecora Hearings. *See* Francis Pecora, *Wall Street Under Oath: The Story of Our Modern Money Changers* (1939). Such banks are financial sophisticates, operating in the heart of our financial markets — and uniquely positioned to influence the apparent value of the securities of public companies they interact with. Their conduct in dealing with public companies in "structured finance" transactions specifically intended to impact a company's reported financial condition, selling the company's securities to investors, and issuing analyst reports recommending purchase of the company's stock — all conduct that can directly impact the company's stock price — is something that carries with it the potential for substantial harm to investors when banks use or employ manipulative or deceptive devices or contrivances. Such conduct is subject to the anti-fraud provisions of the 1934 Act.

CONCLUSION

Section 10(b)'s broad proscription reaches conduct undertaken with the principal purpose and effect of misleading a company's investors and creditors.

Respectfully submitted,

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